MINUTES OF THE MEETING OF THE
MONETARY POLICY COMMITTEE (MPC)
HELD ON SEPTEMBER 21, 2020

P R E S E N T

Dr. Reza Baqir	Chairman & Governor SBP
Mr. Jameel Ahmad	Deputy Governor (Banking & FMRM)
Dr. Murtaza Syed	Deputy Governor (Policy)
Dr. Inayat Hussain	Executive Director (FS & BSG)
Mr. Azam Faruque	Director SBP Board
Dr. Tariq Hassan	Director SBP Board
Dr. Asad Zaman	External Member
Dr. Hanid Mukhtar	External Member
Dr. Naved Hamid	External Member
Mr. Mohammad Mansoor Ali	Corporate Secretary/Director OCS

1. The Monetary Policy Department staff apprised the Monetary Policy Committee on the developments in key macroeconomic indicators since the June 2020 Monetary Policy decision, along with an assessment of the evolving trends.

2. Giving an overview of the real sector, the staff apprised the Committee that domestic demand is showing visible signs of recovery since June 2020, following the lifting of the lockdown restrictions. Furthermore, after a consistent decline in the last two quarters, LSM growth rebounded in July FY21 and recorded an expansion of 5.0 percent (Y/Y), mainly attributed to POL, cement, food and pharmaceuticals. Further, it was noted that the supply side is likely to improve in the coming months due to several fiscal and monetary measures. Moreover, the SBP Business Confidence Survey conducted in August 2020 indicates a significant increase in business confidence for both industry and services. On the agricultural front, however, the latest information shows a 12.2 percent decline in the area under cultivation in FY21 as compared to FY20.

3. Turning to domestic demand, it was apprised that high-frequency indicators registered a notable improvement in recent months. Automobile sales recorded a broad-based Y/Y expansion in August 2020 after a consistent decline since October 2018, mainly attributed to a significant reduction in interest rates along with the sales tax subsidy for tractors announced in the agriculture package by the Government in July 2020. Similarly, sales of the cement sector have recorded a significant recovery since June 2020. Explaining trends in POL sales, the Committee was apprised that these have recorded a Y/Y growth in June 2020, following an almost consistent decline throughout the year. This increase was seen across different sectors of industry, transport and power. The increase in POL sales is mainly attributed to relaxation in the restrictions imposed during the lockdown months. The "Community Mobility Report" released by Google reinforced this view as mobility trends to various marketplaces have recorded improvement during August 2020.

4. It was apprised that expected growth in agriculture sector for FY21 has been revised down by incorporating the reduction in area under cotton cultivation, and the adverse impact of exceptionally heavy monsoon rains. Conversely, the projections for industry have been revised upward by incorporating recent information about major LSM sectors. On an overall basis, LSM is expected to improve during FY21 due to budgetary measures, the construction package, an expected increase in sugarcane production, lower interest rates and a general improvement in macroeconomic conditions. A moderate recovery in the commodity-producing sectors is also expected to help revive growth in the services sector.

5. Based on this assessment, on an overall basis, real GDP growth for FY21 is expected to recover to slightly above 2.0 percent. However, the assessment is subject to several risks. The downside risks include locust attacks, uncertain weather conditions, the possibility of a second wave of the Covid-19 pandemic and, a decline in PSDP spending. The main upsides include improved availability of water that may lead to better than expected agricultural production, stimulus from rural demand and greater than expected recovery in exports. However, the staff apprised the Committee that upside risks are expected to dominate (in the absence of a second wave of Covid-19) and real GDP growth is expected to fall in the range of 1.5-2.5 percent.

6. Discussing global economic conditions, the staff highlighted that after declining in H1-FY20, the Purchasing Manager Index (PMI) for both, emerging and developed countries, witnessed a significant improvement in the last three months. However, due to vulnerabilities associated with the second wave of Covid-19, this improvement in sentiment remains fragile. Global financial markets have also recorded a visible improvement, mainly attributable to low interest rates and commodity prices along with stimulus packages provided by several Central Banks and Governments. It was also highlighted that the Pakistan Stock Exchange (PSX) is following the trend in global financial markets, registering a significant improvement in the last two months. Further, the staff apprised that based on IMF's projection as of August 2020, global trade volumes and global real GDP growth are expected to fall in CY20 before recovering in CY21.

7. After concluding the discussion on the global economy, the staff presented updates on the 'Balance of Payments'. It was highlighted that the Current Account Balance turned in to a surplus in July FY21, primarily due to a decline in imports and a significant increase in workers' remittances. Based on SBP data, imports contracted by 13.3 percent (Y/Y), while workers' remittances increased by 36.2 percent (Y/Y). It was further highlighted that workers' remittances during June-August 2020 reached historic levels. Similarly, the Financial Account recorded a surplus of USD 241 million, mainly due to inflows pertaining to Foreign Direct Investment (FDI) and official loans. FDI increased to USD 115 million in July 2020, compared to USD 57 million in the same month last year.

8. Further, the staff highlighted that an increase in prices as well as the quantum of High Value Added (HVA) textiles led to some improvement in exports during Jul-FY21. As per PBS data, exports recorded growth of 25.1 percent on Y/Y basis during Jul-FY21.

9. Discussing the outlook, the staff apprised the Committee that the projections on exports and imports remained unchanged since the last MPC meeting in June FY20. Contingent on a rebound in global economic growth, exports are projected to grow in the range of 4.0-6.0 percent. Similarly, keeping in view the expected uptick in domestic economic activity, growth in imports is expected to remain in the range of 1.0-3.0 percent during FY21. Further, the staff apprised that going forward there are risks to the level of workers' remittances as the number of workers registering to go abroad with the Bureau of Emigration & Overseas Employment has declined sharply along with the large number of workers who have returned during the last few months. While efforts to divert inflows to formal channels are giving results, growth in remittances is expected to slow down during the remainder of FY21. On an overall basis, the current account deficit is projected to fall in the range of 1.0-2.0 percent of GDP.

10. Presenting developments on the fiscal side, it was apprised that despite the pandemic, the fiscal deficit narrowed to 8.1 percent of GDP in FY20 compared to 9.1 percent in FY19. This was made possible due to both higher non-tax revenues and greater fiscal observed during the first three quarters. These factors helped provide fiscal space to respond to the pandemic, which squeezed tax revenue on the one hand and increased expenditure on the other. Specifically, during Jul-Mar FY20, non-interest current expenditure was contained to the FY19 level while tax revenue was higher. These also helped in narrowing the primary deficit to 1.8 percent of GDP in FY20 from 3.6 percent in FY19. It was also informed that tax revenue started to recover from June,

but heavy monsoon rains and higher refunds led to a decline in FBR revenue in August 2020. Further, it was highlighted that the Public Sector Development Program (PSDP) releases during Jul 01 to Sep 11 FY21 surpassed the releases during Q1-FY20.

11. Presenting projections for FY21, it was explained that contingent on domestic economic activity, in the absence of a second wave of the pandemic, revenues are expected to witness some acceleration in the second half of FY21, but could fall short of the budget estimates. On the other hand, government expenditures are also projected to remain below the budget estimates mainly due to an expected decline in interest payments. Taking into account these developments and various upside and downside risks, the SBP projects the fiscal deficit in FY21 to remain close to the budget estimates, while the primary deficit could be higher than the budget estimates.

12. The MPC members were also apprised about measures taken by the SBP to combat challenges posed by the Covid-19 pandemic. It was informed that reducing the *policy rate* from 13.25 percent to 7.0 percent directly resulted in savings worth Rs. 470 billion (1.1 percent of GDP) for households and businesses. The deferment of *loan principal payment scheme* was also initiated at the start of the pandemic to facilitate borrowers, with total principal payment worth Rs. 650 billion (1.6 percent of GDP) were deferred under this scheme. Similarly, Rs. 184 billion (0.4 percent of GDP) loans were rescheduled. Further, to prevent the layoff of workers, businesses were offered subsidized loans through commercial banks, under the 'Rozgar Scheme'. It was highlighted that Rs. 207 billion (0.5 percent of GDP) was disbursed under this scheme. Lastly, in order to support new investments/Balancing Modernization and Restructuring (BMR), the Temporary Economic Relief Facility (TERF) was introduced in March 2020. Rs. 69 billion (0.2 percent) has been disbursed so far under this scheme and applications worth Rs. 120 billion are in process. Thus, the cumulative amount of SBP's economic policy support measures is Rs. 1,580 billion (3.8 percent of GDP). The Committee appreciated the efforts of SBP and noted that SBP remained proactive during the pandemic.

13. Discussing the monetary aggregates, it was apprised that Broad Money (M2) registered a higher seasonal contraction of 0.83 percent during 01 Jul – 04 Sep, FY21, compared to a decline of 0.4 percent in the same period last year. The contraction was entirely contributed by the reduction in Net Domestic Assets (NDA) of the banking system. The contraction in NDA is broad-based as all of its components saw declines, especially higher retirements in Private Sector Credit (PSC) and net budgetary borrowing from the banking system. However, the net foreign assets (NFA) expanded on account of the improvement in the country's external accounts. On the liability side, the Currency in Circulation (CiC) decelerated and recorded a cumulative increase of Rs. 125 billion during 01 Jul – 04 Sep FY20, compared to Rs. 442 billion in the same period last year.

14. Discussing the Private Sector Credit in detail, it was apprised that PSC witnessed a net retirement of Rs. 111.3 billion in Jul-FY21 compared to Rs. 91.3 billion seen in Jul-FY20, mainly attributed to relatively higher seasonal retirements from the sugar and textile industries. Going forward, the staff apprised that demand side factors are favourable for credit expansion due to a number of elements including: (a) recovery in large-scale manufacturing output as can be seen from aggregate demand indicators like auto, cement, POL sales, etc., (b) declining cost of borrowing as reflected in falling Weighted Average Lending Rates (WALR) and (c) a pickup in credit demand as suggested by the recent surge in both the number and the volume of loan applications in the last two months (June-July). Supply side factors indicate a mixed picture with an uptick in credit risk due to an increase in fresh Non Performing Loans (NPLs) and an expected moderation in bank deposits owing to relatively higher returns on alternate saving instruments, such as the NSS. Taking into account these factors, PSC growth is estimated to fall in the range of 7.0-9.0 percent in FY21.

15. The staff then apprised the MPC about recent developments with respect to inflation. It was explained that inflation has remained low in the last few months. On a Y/Y basis, the National CPI inflation decelerated to 8.2 percent in August FY21 compared to 10.5 percent in August FY20. The decline in inflation is primarily attributed to lower demand base effects and the receding impact of non-reporting items in Q4-FY20 due to Covid-19.

16. Moreover, it was explained that M/M National CPI inflation increased by 0.6 percent in August 2020 compared to 2.5 percent in July 2020. The CPI inflation in urban and rural centers was recorded at 0.8 and 0.4 percent (M/M) in August 2020, respectively. This moderation in inflation is primarily attributable to a deceleration in food prices after Eid-ul-Adha, subdued demand conditions and an inflation-neutral Federal Budget-FY21.

17. In FY21, National CPI inflation is expected to fall in the range of 7.0-9.0 percent but this projection is subject to several risks. The upside risks include increase in prices of essential food items, heavy rainfalls and upward adjustments in fuel and utility tariffs. The downside risks include a second wave of the pandemic and a deceleration in demand.

18. Concluding the presentation on inflation, the MPD staff presented inflation projections based on alternative scenarios for the exchange rate and GDP growth from the expected path in the baseline The Committee then deliberated on all the scenarios and their possible implications for the policy rate.

Financial Markets and Reserve Management

19. Apprising the Committee on monetary policy implementation, the staff stated that the overnight interbank repo rate remained around 7.09 percent, on average, against the policy target rate of 7.0 percent. It was explained that in order to ensure an effective implementation of the monetary policy stance decided by the MPC, SBP had to consistently inject liquidity. The average outstanding net injection since the last MPC meeting stood at Rs. 1.07 trillion.

20. It was explained that the yield curve is now upward sloping, indicating that the market does not seem to expect further cuts in the policy rate.

21. Further, MPC was appraised that liquidity in the FX market was improving and PKR-USD parity had been showing orderly two-way movement and had appreciated since the last MPC meeting on June 25, 2020. The improvement in liquidity conditions in the foreign exchange market was primarily due to record high remittances and an overall improvement in BoP, which also resulted in slight appreciation of the PKR against USD.

Model-Based Assessment

22. Before discussing the model-based assessment, the Committee was apprised that apart from updating the model with outturns for Q4-FY20, as usual, all assumptions were updated to carry out the latest simulations, using the available information. Further, the staff highlighted that contrary to the projections shared in the last MPC, the model is now indicating an upward revision in the inflation trajectory, Inflation projections for FY21 have accordingly been revised upward. Moreover, the model is now showing a stable interest rate path for the foreseeable future as compared to the declining interest rate path presented to the MPC in June 2020 meeting. It was also pointed out that the shorter end of the current interest rate path is in line with prevailing secondary market expectations of interest rates up to a one-year horizon.

23. After discussing the future inflation and interest rate paths, the staff discussed the projected growth pattern in detail to analyze the projected policy rate movement.

24. At the end, the staff presented projections based on alternative scenarios such as high international oil prices, as well as high and low GDP growth for FY21. The Committee then deliberated on all the scenarios and their possible implications for the policy rate.

Result of Surveys on Monetary Policy

25. The staff apprised the Committee that the last wave of the Consumer Confidence Survey (CCS) was conducted during September 2020. The results suggested that consumer confidence had recovered, after falling to the lowest level in the last six-years in May 2020. Further, it was highlighted that although consumer inflation expectation had declined since the last wave of the survey, it remained above the historical median level, suggesting that consumers are still concerned about inflation.

26. Discussing business confidence, it was informed that the results showed a significant uptick in overall sentiment across Industry and Services, after recording the lowest level of business confidence in April 2020. Further, it was highlighted that in contrast to consumers, expectations of businesses have increased since the last survey for overall inflation, input costs and average selling price of their goods and services.

27. Further, presenting the results of the Bank Lending Survey, it was informed that the results suggested that the Senior Loan Officers of commercial banks expect credit demand and availability of funds to remain high in Q1-FY21.

28. Lastly, sharing the results of 'Survey of Other Forecasters', it was explained that the analysts expect real GDP in FY21 to grow at 1.0-3.0 percent and their average inflation projection for FY21 is 7.0-9.0 percent as per the latest wave conducted in September 2020. It was also highlighted that most of the forecasters foresee no change in SBP's policy rate.

Monetary Policy Deliberations and Decision Vote

29. Following a detailed discussion, the MPC unanimously decided to keep the policy rate unchanged. This reflected the view that while the outlook for both growth and inflation had risen slightly, there was a need to keep monetary conditions stable in light of still significant uncertainty about the trajectory of growth. As a result, it was important to maintain an accommodative monetary stance in order to nurture the nascent recovery while safeguarding inflation expectations and financial stability.

30. The Committee then scripted the Monetary Policy Statement.

DECISION:

- *The policy rate is kept unchanged at* 7.0 percent.
- *The Monetary Policy Statement – September 21, 2020 is approved.*